

1 **REBUTTAL TESTIMONY OF**
2 **THOMAS R. OSBORNE**
3 **ON BEHALF OF**
4 **SOUTH CAROLINA ELECTRIC AND GAS COMPANY**
5 **DOCKET NO. 2004-178-E**
6

7 **Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS**
8 **ADDRESS.**

9 A. My name is Thomas R. Osborne. I am a Managing Director in the Global
10 Power Group within UBS Investment Bank (“UBS”). My business address is UBS
11 Investment Bank LLC, 299 Park Avenue, New York, NY 10171.

12
13 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS**
14 **PROCEEDING?**

15 A. Yes.
16

17 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

18 A. The purpose of my rebuttal testimony is to explain why the group of
19 comparable companies presented in the Prepared Direct Testimony of Kevin W.
20 O’Donnell (October 18, 2004) is not in the aggregate appropriate for assessing the
21 risks faced by investors in SCE&G.

1 **Q. PLEASE EXPLAIN WHY THE O'DONNELL PEER GROUP IS NOT A**
2 **FAIR PROXY FOR SCE&G?**

3 A. The O'Donnell Peer Group is not a fair proxy for SCE&G because it
4 includes companies whose risks are meaningfully different from those of SCE&G.
5 I have formulated my opinion based on seventeen years of financial industry
6 experience within the utility sector. The Osborne Peer Group for SCE&G was
7 selected based on a comparison of several key operational and financial metrics
8 across a range of U.S. utility companies from various geographic regions. Among
9 the key metrics I considered were: total market capitalization, capital structure,
10 financial leverage, credit ratings, Standard and Poor's business profile score, the
11 overall contribution of assets and operational flows from regulated electric and
12 regulated gas operations, the extent of investment in unregulated businesses, and
13 profitability.

14 Among the important factors I considered is relative size, as measured by
15 total market capitalization. As stated in the Direct Testimony of Burton G Malkiel
16 (page 20, 16-17), "the rates of return of smaller companies tend to be higher than
17 is the case for larger companies, reflecting their greater risk level". Given its
18 relative size, SCE&G would theoretically be considered a mid-cap company by
19 Ibbotson. Thus, the SCE&G Peer Group should include only companies within the
20 range of mid-cap companies as set by Ibbotson.

1 On this basis, all the following companies from the SCE&G Peer Group
2 should be excluded because they do not fall within the Ibbotson mid-cap range:
3 Ameren Corp, Avista Corp, CH Energy Group, Cinergy Corp, Constellation
4 Energy Group Inc, Dominion Resources Inc, DTE Energy Co, Duke Energy Corp,
5 Exelon, MGE Energy, NiSource Inc, PPL Corp, Public Service Enterprises Group,
6 and Sempra Energy.

7 Furthermore, SCE&G's financial leverage, credit ratings and profitability,
8 among other factors, suggest that the company should be compared to a peer group
9 with credit ratings reasonably proximate to those of SCE&G within the
10 investment-grade spectrum. On this basis, TECO Energy Inc. which has been
11 assigned a BB senior unsecured credit rating from Standard and Poor's and a Ba2
12 senior unsecured credit rating from Moody's Investors Service, and Puget Energy
13 Inc. which has been assigned a Ba1 long-term issuer rating by Moody's Investors
14 Service, should also be excluded.

15 OGE Energy Corp should also be excluded from the appropriate peer group
16 based on its business mix. OGE Energy's non-utility business investment is higher
17 than that of any peers I selected for SCE&G, at approximately 55% of total assets
18 (as of 12/31/03). Moreover, the business mix within OGE Energy's non-utility
19 segment further reduces its comparability. This segment includes investments in
20 intrastate and interstate gas pipelines, gas storage, gas gathering systems, gas
21 processing, and energy marketing and trading.

1 PNM Resources Inc (“PNM”) should be excluded on the basis of regulatory
2 risk and a pending acquisition. Public Service Company of New Mexico, a
3 subsidiary of PNM received its most recent rate case decision on January 15,
4 2004. The New Mexico Public Regulation Commission’s rulings during the course
5 of this gas rate proceeding for Public Service Company of New Mexico, were
6 viewed as being decidedly negative from an investor viewpoint. Additionally,
7 PNM announced the acquisition of TNP Enterprises, Inc. from a private investor
8 group, on July 25, 2004, for approximately \$189 million comprised of equal
9 amounts of PNM common stock and cash. PNM will also assume approximately
10 \$835 million of TNP Enterprises' net debt and senior redeemable cumulative
11 preferred stock. The pending acquisition by PNM creates uncertainty related to
12 regulatory approvals, PNM’s financing plans (which will require substantial de-
13 leveraging) and integration of the merged operations.

14 Northeast Utilities should be excluded on the basis of the risks inherent in
15 its unregulated businesses, including exposure to volatile commodity prices
16 through its merchant energy segment. While Northeast Utilities has stated that it
17 does not intend to significantly increase its investment in these businesses, the
18 company is nonetheless exposed to volatility in power pools in New England,
19 New York and the PJM Interconnection. This makes its risk profile different from
20 that of SCE&G, and on that basis it should be excluded from the SCE&G peer
21 group.

1 Alliant Energy Corp. (“Alliant”) should be excluded as it faces different
2 business risks from those of SCE&G. Alliant’s non-regulated business investment
3 is approximately 21% of its total assets (as of 12/31/03), which includes
4 investment in international operations. On July 27, 2004, Alliant Energy Corp.
5 announced its second quarter results for 2004, where international operations
6 posted a \$0.09/share loss vs. a \$0.02/share profit for the same period in 2003. A
7 portion of this decline was related to foreign exchange losses, but higher operating
8 and interest costs at the Brazilian distribution business impacted results as well.
9 Moreover, there were litigation-related expenses due to an ongoing dispute
10 between Alliant and its partners over dividends that may have been paid before
11 they were permitted. On January 22, 2003, Alliant announced a dividend cut from
12 \$0.50/share to \$0.25/share, due to lower 2002 income from continuing operations.
13 This was primarily due to a net loss of \$47 million from Alliant’s Brazil
14 investments in 2002, compared to a net loss of \$24 million in 2001. Based on its
15 business mix and the 2003 dividend cut, Alliant should be excluded from the
16 SCE&G Peer Group.

17
18 **Q. WHY WOULD YOU INCLUDE PINNACLE WEST CAPITAL**
19 **CORPORATION IN THE SCE&G PEER GROUP?**

20 **A.** PNW has been included as it fulfills many of the criteria for inclusion in the

1 Peer Group. The company's total market capitalization is within the range of mid-
2 cap companies as set by Ibbotson, the company has investment grade credit ratings
3 and a Standard and Poor's business profile score of 6. The company is active in
4 the generation, transmission and distribution of electricity. It also has a high
5 proportion of regulated assets, with only 8% of its capital invested in non-
6 regulated assets. PNW therefore should be included in a current peer group as
7 being reasonably comparable for purposes of estimating SCE&G's cost of capital.

8
9 **Q. ON OCTOBER 18, 2004, SCE&G ANNOUNCED THAT IT HAD**
10 **ENTERED INTO A STIPULATION AND SETTLEMENT AGREEMENT**
11 **WITH THE STAFF OF THE SOUTH CAROLINA PUBLIC SERVICE**
12 **COMMISSION IN CONNECTION WITH SCE&G'S PENDING RETAIL**
13 **ELECTRIC RATE INCREASE APPLICATION THAT WAS FILED ON**
14 **JULY 1, 2004. HOW HAS THE MARKET RECEIVED NEWS OF**
15 **SCANA'S SETTLEMENT AGREEMENT WITH THE COMMISSION**
16 **STAFF?**

17 A. The capital markets reacted in a reasonable manner as investors'
18 expectations were largely met. There was a slight up-tick in SCANA Corp's share
19 price (though it remained well within the band of its 52 week high and low)
20 following the announcement due to the reduction of uncertainty and the

1 consensual nature of the settlement. SCANA Corp and SCE&G's bond spreads
2 remained materially unchanged following the announcement. This mild but
3 reasonable reaction to the news of the proposed settlement demonstrates that the
4 capital markets viewed the settlement as fairly balancing the interest of customers
5 and shareholders and as continuing constructive regulation, consistent with how
6 the capital markets have viewed South Carolina's oversight of SCE&G in the past.

7
8 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

9 A. Yes.